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SUBJECT: UKRAINE: ENGAGING YANUKOVYCH, THE MAN OF THE MOMENT

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Classified By: Ambassador for reasons 1.4(a,b,d).

¶1. (C) Summary. Love him or hate him, the Ukrainian political elite and intelligentsia agree that Prime Minister Yanukovich is the man to deal with right now. Four months ago Yanukovich was painted variously as a puppet of oligarch Rinat Akhmetov, the Party of Regions, or the Kremlin, but he has come into his own as the center of decisionmaking, at least for now, in Kyiv. A combination of wily political moves to grab power at President Yushchenko's expense and an effort to position himself as the moderating force in a coalition of radicals and recalcitrants have increased Yanukovich's status. At the same time, Yanukovich appears to be under pressure from Moscow and from some in his own party to move Ukraine closer to Russia -- or at least, to resist the temptation to get too close to the West. Even Yanukovich's detractors, such as opposition leader Tymoshenko and beleaguered Foreign Minister Tarasyuk, argued to EUR A/S Fried and the Ambassador last week that positive U.S. engagement with Yanukovich is the best way to maintain hope for continued political and economic reform at home, support Ukraine's Euro-atlantic direction, and keep the Kremlin at bay.

¶2. (C) This is a window of opportunity. Yanukovich has asked us to judge him on his deeds, not his words. He has said the right things in venues like the Washington Post, but made contradictory statements to his electorate in Eastern and Southern Ukraine. His political instincts may not always be democratic, but he understands the political necessity of a positive relationship with the West, is eager to overcome the negative image he has in the West from the 2004 elections, and appears to be motivated to protect Ukrainian sovereignty from Russian encroachment. Engaging him, as we have done since he came into office, has kept him restating his interest in WTO, the EU, NATO, and reform. This repetition may be even paying off as the Rada finally moves to pass WTO legislation, apparently on Yanukovich's orders. As he travels to Washington in two weeks, the ball is now clearly in the PM's court. End summary and comment.

Who is Yanukovich?

¶3. (C) People favorably inclined to Regions, including MPs and academics, and now even his "orange" opponents on the other side of the political fence describe Yanukovich as the moderating center of the party. They hold up the threat of the "radical" wing of Regions led by former Kharkiv governor Kushnarov as the reason why Yanukovich maintains tight control over the party. Others see the PM as from the mold of the early post-Soviet leaders, more comfortable with issuing "ukazi" than trusting democracy. And many were impressed by Yanukovich's ability to buckle down after his 2004 political disaster, remake himself and his party into this country's first "post-Orange" politician and lead his

party to political victory in the March 2006 elections.

14. (C) Across the political spectrum here no one believes that Yanukovych would rather be a puppet of Moscow than the leader of his own country. During his 18 months in political exile, Yanukovych transformed himself into a politician who understands how to work in post-Orange Revolution Ukraine and to take advantage of a loosely-defined political system. Tarasyuk confirmed to A/S Fried and the Ambassador that Yanukovych was not the man he had been two years before; he didn't want his image to be tarnished in the West, as Kuchma's had been, and was working hard to repair damage from the 2004 presidential campaign. This is an opening that the West can use to engage Yanukovych and his team.

15. (C) Yanukovych has been clear in his recent conversations with us that he wants to shake the image of authoritarianism and corruption that dogged him in 2004. As the head of the government now, no longer just a Kuchma lackey, Yanukovych is trying to take responsibility for his actions and the actions of his government. Yanukovych wants respect, to polish his image, and to protect Ukraine's sovereignty. It may be difficult to appeal to his moral or ethical code, but he may respond to sound practical arguments. He is aware that a good relationship with the West strengthens his hand with Russia. And he is interested in economic reforms that would increase trade and investments that benefit Ukraine--and his financial partners.

New Behaviors - Seeing the Light

16. (C) In no area has there been a bigger turnaround than with regard to WTO accession. Soon after taking office in

KYIV 00004313 002 OF 003

August, Yanukovych and his team initially sounded as if they might be having second thoughts about WTO accession, which in retrospect may have been more political caution than a change in policy (septel). Once consultations with industry showed that there was little opposition to WTO and the President continued to signal the importance of keeping the accession on schedule, Yanukovych appeared to have made the political calculation that there was nothing to be gained by delaying WTO. It is clear from our recent discussions with Rada deputies that Regions has orders to pass WTO legislation and with relatively few changes, and the Socialists are on board as well. Still, we sense Yanukovych's government has moved on WTO not because of some conversion to free trade, although there are clearly Regions businessmen who know the advantages that WTO membership will bring, but rather for the pragmatic reason they believe it will benefit them.

17. (C) In other policy areas, Yanukovych's government has also proven to be more flexible about resorting to old-style policies, although this flexibility comes short of a commitment to market principles. When they came into office, Yanukovych and DPM Azarov signaled their desire to re-install the Special Economic Zones (SEZs). However, in practice they have moved cautiously, making some modifications to the SEZ proposals, and recently agreeing to allow the SEZ proposals to be considered separately from the budget. Similarly, Yanukovych has moved away from any major change in economic relations with Russia, including maintaining a polite silence on the Single Economic Space and on Russia's suggestions to "synchronize" the timing of WTO accession.

Checks on Yanukovych's Power

18. (C) As the rapid movement on WTO in the last month has demonstrated, Yanukovych can pull key decisions and order votes when they are needed. At these times, he seems to be firmly in control over the general policy direction of the country. At other times, however, there is more internal government squabbling now than the last time Yanukovych was

PM. For example, there is an open fissure between Energy Minister Boyko and Deputy Prime Minister Kluyev on energy policy. Rumbblings within Regions suggest that some level of dissent is tolerated in the party too. But Hrytsenko caveated that while Yanukovych may not oversee every decision taken, he selected the people who make them and he is aware of their policies, thereby suggesting that Yanukovych was tacitly approving them.

¶9. (C) There are also societal constraints on Yanukovych now that were not there before the Orange Revolution that may moderate some of his impulses. The press is now freer to criticize him or to expose mistakes or corruption if they find them. Yanukovych is now responsible to an electorate that may feel more empowered to vote politicians out of office than they did before. The opposition, led by Tymoshenko, has a strong base of popular support. Ukraine still has a long way to go on democratic development, but Yanukovych is taking these factors into account as he formulates his strategies.

But Old Habits Die Hard...

¶10. (C) Nevertheless, there have been instances already when it is clear that Yanukovych and his circle have fallen back on their old ways, such as inserting government controls in the economy and tolerating corruption. Internal Affairs Minister Lutsenko told the Ambassador on November 17 that contract killings have started up again, not because the PM is involved, but because organized crime feels safe that there will be no follow up from the government. NSDC Secretary Haiduk told Fried and Ambassador the Cabinet is

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using economic policies to pressure businessmen in the Rada to support the coalition and a number of contacts, including Tymoshenko, have passed on complaints of pressure on non-Donetsk businesses. On November 16, Defense Minister Hrytsenko told us there was less accountability and transparency now and described his fight against Regions's property grab attempts within the MOD (reftel).

¶11. (C) On economic issues, Yanukovych and his government have shown a predilection to reach for familiar policy tools.

Yanukovych (and his economic team led by Azarov) came into office with the conviction that they, unlike the "orange" teams, already knew how to manage the economy. After all, they would note, hadn't they obtained 12 percent GDP growth in their last year in office? When there was uncertainty about the availability of budget revenues, they went back to accumulating arrears in the payment of VAT refunds, a tried and true policy. Similarly, when faced with a somewhat weak harvest and soaring prices on the international grain market

KYIV 00004313 003 OF 003

that threatened to raise the cost of the GOU's bread subsidies, the GOU intervened in the market and used licensing and quotas to halt exports. Both of these solutions had the added benefit of helping friendly interests and the latter offered good opportunities for rent-seeking behavior (allocating quotas). Yanukovych almost certainly did not design these policies, but he has shown little ability or will to change them.

Russian Pressure

¶12. (C) There are concerns among "orange" forces in and out of the government, as well as among think tankers, that the Russians are taking a much more activist approach with Yanukovych than they did with Kuchma, possibly holding good gas prices and a stable energy relationship hostage to a variety of demands, such as coordinated WTO accession, the removal of Tarasyuk and Hrytsenko from the government, or a toning down of language on NATO membership. There also seems

to be a lot of agreement that there are some in Yanukovych's circle, including Azarov and Boyko as well as Foreign Policy Advisor Orel, who are very close to Russia and are nudging the PM to move in that direction.

¶13. (C) All agreed that the best way to keep Yanukovych from sliding towards Moscow was to remind him that he had options. Tarasyuk and Tymoshenko argued to Fried and Ambassador that this meant regular contact with Washington officials. There seems to be agreement that Yanukovych does not want to be the governor of the Russian province of Ukraine and his business allies do not want to compete directly with Russian big business. Yanukovych himself made a pitch to A/S Fried to be understanding about the Russia factor. For example, the West needed to understand that until Ukraine could diversify its energy supplies, Kyiv needed to be mindful not to provoke Moscow. Strong statements on NATO now could only lead to high gas prices.

The Ball is in Yanukovych's Court?

¶14. (C) Many in opposition to Yanukovych talk about either undoing the constitutional reforms that gave him his power or holding early elections next spring. The question is whether either of these options is good for the country; or whether ensuring political stability might be the better alternative. In large part, it depends on which direction Yanukovych takes Ukraine in the next six months. At a November 17 meeting with Fried, Presidential Secretariat Chief Baloha, and to a lesser extent Yushchenko, were clear that it was too soon to assess Yanukovych's intentions, but that all options were still on the table. The President, who is averse to confrontation, is clearly still looking for cooperation, but he has said that he will not accept cooperation at the price of Ukraine's sovereignty or sacrifice of its European course.

¶15. (C) Yanukovych's U.S. visit will be his chance to show and convince us that he is different, that he has changed, and that he is serious about a real relationship with the West that balances his long-standing ties with Russia. His audience will be senior USG officials and western public opinion, but it will also be his critics and skeptics here in Ukraine who will pay attention to his every statement and every meeting. At this point, Ukrainians of all political stripes agree that Yanukovych is the man of the moment and that successful engagement with him is the best way to maintain the gains of the Orange Revolution in terms of democracy, free speech and media, and integration with Europe. Whether or not he can deliver is up to him.

¶16. (U) Visit Embassy Kyiv's classified website:
www.state.gov/p/eur/kyiv.
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